THE ECONOMIC OUTLOOK AND CURRENT FISCAL ISSUES

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THE ECONOMIC OUTLOOK AND CURRENT FISCAL ISSUES

WEDNESDAY, SEPTEMBER 8, 2004

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to call, at 10:35 a.m., in room 210, Cannon House Office Building, Hon. Jim Nussle (chairman of the committee) presiding.

Members present: Representatives Nussle, Gutknecht, Thornberry, Ryun, Toomey, Hastings, Brown, Wicker, Bonner, Barrett, Hensarling, Brown-Waite, Shays, Garrett, Crenshaw, Portman, McCotter, Franks, Spratt, Moran, Moore, Neal, Edwards, Ford, Capps, Baird, Cooper, Emanuel, Kind, Thompson, Lewis, Hooley, DeLauro, Scott, and Davis.

Chairman NUSSLE. Good morning and welcome back—members of the Budget Committee and colleagues—to our hopefully brief September session, getting our work done and going home as quickly as possible. We have two hearings. This will be the first of two hearings on the economy and the budget that the committee will hold today.

This morning we have back with us the chairman of the Federal Reserve, Alan Greenspan, to discuss the economic outlook and the Federal budget. Let me note for members that the chairman is available to be with us today until about 12:30, which is about 2 hours, so I will ask everyone to keep their questions to the allotted time, including myself, and we will get in as many questions as possible.

Mr. Chairman, welcome back to the Budget Committee. You were always very generous and gracious with your time coming before all of our committees, but particularly the Budget Committee, and we welcome you back. It has been about 6 months since you last testified before this committee. And at this time—I should say at that time, we were already seeing some stronger, real GDP growth. In fact, at that time, it was the largest growth, the strongest growth we have seen in about 20 years. But we are still waiting for evidence of stronger jobs growth. We have seen good jobs growth. It could be better. We are all obviously very interested in much more sustained growth in jobs for all sectors.

Since you last came before us, the U.S. economy has created about 1.2 million new jobs. Total employment has risen to a record high of nearly 140 million. Just last week, we saw an employment report showing 144,000 new jobs in August and the unemployment rate falling to 5.4 percent.

Alone, these numbers may be impressive, but we really can't appreciate or understand the significance of these numbers without putting them in some context to the last few years. We all know the circumstances well: the economic downturn and recession that began in 2000; the September 11 attacks and the resulting international war against terrorism. There was a perfect storm, if you will—as it has been called by many—of extraordinary circumstances converging on our country and on our economy, one on top of the other. Thankfully Congress came together, together with the President, and did what it had to do. We took quick, aggressive action to correct some of the deficits in the past, the homeland security deficit, the military defense deficits; we had to protect our country and, for that matter, the growth in our economy, the deficit economic growth which will be part of our discussion today. We needed to boost the economy and to help get Americans back to work, so we passed tax relief in the year 2001. Passed it again in the year 2002. And passed tax relief again in 2003. We now know without question that those economic policies are working and beginning to show sustained growth.

Let me show you a chart of the strong, real GDP growth and expected growth that we believe will continue. The Blue Chip forecast, as you can see since the end of 2001, but particularly since the end of 2002, we have seen good, strong growth. The economy first went negative in the third quarter of 2000, before President Bush took office. And after that, the biggest quarterly decline happened in the third quarter of 2001, coinciding with the September 11 attacks. But today our economy is in a much different and certainly much better position than we were 4 years ago, when the stock market bubble was bursting, when manufacturing activity and jobs were falling, and when the economy was entering a recession.

Over the past year the U.S. economy has grown at a 4.7 percent rate, one of the strongest growth performances in 20, years and the Blue Chip private economists expect real GDP growth to be strong and continue at a 4 percent rate in the second half of this year.

Let's turn to manufacturing activity. Manufacturing activity and the industrial production are growing strongly. Manufacturing activity recently has been at its strongest pace in 20 years. The home ownership rate is at a record high, and housing markets have recently been running at their highest levels in 20 years.

Next on unemployment, perhaps most important, labor markets are improving. The unemployment rate is down to 5.4 percent from 6.3 percent in June of last year. That is a lower unemployment rate than the averages for any of the last three decades, the 1970s, the 1980s and the 1990s. There is good news on jobs. Payroll employment has increased by over 1.7 million jobs in the past year. Manufacturing employment has increased by 100,000 over the past 6 months.

Let me repeat that because it is important to show what kind of growth we are creating: 100,000 jobs have been created in manufacturing along in the past 6 months. More Americans are working today than at any time in our Nation's history, as total employment is at a record high of 140 million people.

So, again, let us be clear. The tax relief that we passed happened at the right time to help get this economy and jobs growing again, and we are finally getting back to work. Without the tax relief, today real GDP would be lower, unemployment would be higher, and there would be fewer jobs that had been created.

Even with this good news that we have seen, there still is work that needs to be done, as every one of us in this room and every member of this committee who has returned from their district knows. There are still too many Americans who want to work but still can't find a job, so our work is clearly not done. We need an economy that continues to produce steadily expanding job opportunities so that everyone who wants to work can work.

So we have asked Chairman Greenspan back with us today not only to review the current economic picture, but also to hear what he believes is our best course for keeping this momentum going.

This discussion certainly wouldn't be complete without a review of our deficit situation. Just yesterday morning, we heard from the Congressional Budget Office that the deficit is coming in lower than expected, because tax receipts are growing faster than expected. That proves what we have been saying, that one of the best ways to reduce the deficit is to have strong economic growth. But we are still clearly not where we want to be. We have seen budget deficits now for the last couple of years, and I am sure we will take some time today to do the usual round of finger pointing of how we got here.

So let us review, just in case there are any questions. We incurred these deficits because of an economic slowdown and a recession that began in 2000 and continued into 2001 that President Bush inherited when he took office and because of the spending policies that were adopted after September 11. The response to September 11 required an increase in spending that was intentional. In fact, most of us in this room voted for those spending increases. They were very necessary spending increases to rebuild and shore up our homeland security and our defense and to fight the ongoing war against international terrorism.

Even though we have seen a return to deficits, I believe that we have adopted the right policies at the right time to protect America and to get our Nation's economy moving again. But now we have got to work just as hard and just as passionately to get ourselves back on the path to balance. And I know full well what I believe we need to do to get that done. As I know Chairman Greenspan has said time and time again, not only do we have to keep the economy growing and creating jobs, but we have to control Federal spending. It is really a pretty simple concept. Deficits are a result of overspending, so to reduce our deficits we need to restrain our spending.

I am proud to say this committee has been at the forefront of the efforts in this Congress to do just that. We wrote a tight budget and fully funded our priorities, but that also compelled us to restrain lower priority items. We passed a budget in this committee and from the House that froze spending except for our national security issues. Did we hear people scream and yell not only for every program, but for every policy which was somebody's pet project? Yes, we did. It has not been an easy process, but we are doing it and sticking to the budget, in the House of Representatives in particular, and it is making a difference.

Chairman Greenspan, you have urged this Congress and this committee to restore statutory budgetary controls, known as discretionary spending caps and pay-as-you-go requirements. I want you to know your desire for return to budgetary controls in this law has been shared by many of us in Congress. You cannot manufacture a consensus for statutory controls when the consensus for budgetary discipline is not strong enough. While there are many Representatives and Senators who are deeply concerned about excessive spending and budget deficits, I don't believe, unfortunately, there is yet enough consensus to enact budgetary controls into law. I have now tried twice to push legislation through Congress to extend budgetary controls, a more comprehensive reform in 2000 and a much more modest proposal this year. And while I was able to obtain a majority vote in this committee, we were unable to obtain a majority in the House for either the comprehensive proposal or a more limited package. Just because there is not a consensus does not mean that there aren't those of us who aren't deeply concerned about excessive spending and budget deficits, and we will not stop advocating for those budgetary controls.

Additionally, we must keep the same vigilance for adhering to our budget resolution, once passed, and I intend to do that for the remainder of this year and the remainder of my term as chairman of the committee.

I will turn it over to Mr. Spratt for any comments he wishes to make at this time. Mr. Spratt.

Mr. SPRATT. Thank you, Mr. Chairman. And Chairman Greenspan, welcome once again. You come at a good time. Yesterday, the Congressional Budget Office told us that the Federal Government this year will run the largest deficit in our history, at least in normal terms, $422 billion; $574 billion when the Social Security surplus is excluded. This surpasses last year's deficit by $47 billion. Although the economy seems to be getting better, the bottom line of the budget is it is clearly getting worse and it is not supposed to work that way, at least—except when you have a structural deficit.

CBO assumes 4½ percent growth this year, 4.1 percent growth next year, 3 percent thereafter. But it also shows, based upon those assumptions, that between now and 2010 deficits hover in the range of $300 billion. They barely go down and they never go away. That is a definition of a structural deficit.

CBO's forecast also shows that deficits will drop dramatically after 2010, for one salient reason. At the end of calendar year 2010, the tax cuts sought by the Bush administration, enacted by Congress mostly with the votes of our Republican colleagues, will expire. This event alone, the expiration of the Bush tax cuts, will move the deficit from $298 billion in 2010 to $70 billion in 2012. That to me speaks volumes about the source of the problem, the source of today's deficits.

CBO's forecast is what we call a baseline of current services forecast. And as you know better than we, by law CBO is required to assume that appropriations this year, including defense supplementals, will be repeated next year; that tax cuts that are written to expire on their own term on a date certain do, in fact, expire. They have to assume that by law.

On our side, we have gone back and factored some political reality into these forecasts. We have adjusted the baseline and adjusted it slightly lower, and we think a more realistic level of defense spending. Let us hope we don't have a recurring cost of $115 billion a year for the Iraqi and Afghan deployments.

We have extended all the tax cuts except for bonus depreciation. And we have added to the tax cuts an alternative minimum tax, because we think that is politically inevitable and realistic. We simply indexed the key variables. When you hold the tax cuts constant and don't assume their expiration or appeal and let defense spending grow as CBO projects, here is what happens to the bottom line. Those numbers are a little small, but you can see that we go from $422 [billion] down to $361 [billion] and thereafter, the deficit never dropped below $320 billion. By the end of our forecasting period, 2014, the deficit is $504 billion. That means the unified deficit, the deficit after deducting Social Security surpluses between 2005 and 2014, adds to $3 trillion, $911 billion. Deficits in the basic budget without Social Security's offsetting surplus comes to $6.3 trillion. Debt held by the public will be $4.3 trillion at the end of this fiscal year. It will be $8.4 trillion by the end of 2014, a little more than double. Total statutory debt, including debt held by government trust funds today is $7.4 trillion. By 2014, according to our calculations, when you make the adjustments we have made to the CBO forecast, total statutory debt will be $14.9 trillion. It will double, more than double between now and 2014 if we follow this course.

Basically, that is our question to you today, Mr. Greenspan. These are numbers on paper. We would like your candid assessment of what could happen if we take this fiscal path into the future. Is this course even sustainable? What are the consequences of running budget deficits and accumulating debt of this magnitude over a 10-year period of time?

Secondly, we would like to hear you testify again what you have told us several times before. It has been within the last year that I think you pronounced yourself a convert, a believer; that you were skeptical of the efficacy of budget process reforms in the early 1990s, but you believe that those reforms we adopted in the Budget Enforcement Act actually contributed significantly to our successes in the 1990s. We have allowed those to expire. Congress has allowed those to expire, and we would like to hear again your reaffirmation that those are part of the solution to this problem that confronts us right now.

Thirdly, of course, is the overarching question of the state of our economy. A lot of forecasters are beginning to talk about an economy that has been running on tax cut stimuli and mortgage refinancing cash. And now that those forces are pretty basically spent, we are wondering if the shock of the spike in oil prices is going to affect the recovery and make this a precarious economy.

And, finally, with respect to jobs, we hope you will touch upon this topic, too, because there are today 1.650 million fewer jobs in the private sector than there were in January, 2001; 1.650 million fewer jobs. Why is this recovery so laggard despite huge fiscal stimulus in creating jobs in the private sector?

In addition, you have often spoken, Mr. Chairman, in support of the establishment survey as being the more definitive estimate of the job situation in the country as opposed to the household survey. And since this topic comes up every time the jobs picture is discussed, we would appreciate your opinions on that.

That is enough for me to lay in front of you. I hope you will be able to address in your direct testimony, or the answers you give us to the questions we have, those particular topics because I think those are the ones of preeminent concern.

Thank you. We look forward to your testimony.

Chairman NUSSLE. Mr. Greenspan, your entire testimony will be made part of the record and you may proceed and summarize as you wish. Welcome back again to the Budget Committee.

STATEMENT OF HON. ALAN GREENSPAN, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. GREENSPAN. Thank you very much, Mr. Chairman, and members of the committee. I will excerpt from my rather extended prepared remarks.

I am pleased to be here today to offer views generally on the economy and on current fiscal issues, but I want to emphasize I speak for myself in a number of these areas and not necessarily for the Federal Reserve, as I do on numerous other occasions officially before the Congress.

As you know, economic activity hit a soft spot in late spring after having grown briskly in the second half of 2003 and the first part of 2004. Consumer spending slowed materially and employment gains moderated notably after the marked step-up in early spring. That softness in activity no doubt is related in large measure to this year's steep increase in energy prices.

The most recent data suggests that, on the whole, the expansion has regained some traction. Consumer spending and housing starts bounced back in July after weak performances in June, although early readings on retail sales in August have been mixed. In addition, business investment remains on a solid upward trend.

In the manufacturing sector, output has continued to move up in recent months, though part of that rise likely reflected an increase in inventory investment. In the labor market, though job gains were smaller than those of last spring, non-foreign payroll employment growth picked back up in August.

Despite the rise in oil prices through mid-August, inflation and inflation expectations have eased in recent months. To be sure, unit labor costs rose in the second quarter as productivity growth slowed from its extraordinary pace of the past 2 years and employee compensation per hour remained on an upward trend. As best we can judge, the growth in profit margins of nonenergy, nonfinancial corporations which, at least from an accounting perspective, had contributed significantly to price pressures earlier, has recently slowed. Moreover, increases in non-oil import prices have lessened, a development that, coupled with the slowing of profit margin growth, has helped to lower core consumer price inflation in recent months. Crude oil prices have come off their highs of mid-

August and gasoline prices, which rose rapidly last spring, have fallen.

Nevertheless, the outlook for oil prices remains uncertain. Higher prices have damped the consumption of oil, but the growing concerns about long-term supply along with large prospective increases in demand from the rapidly growing economies of China and India have propelled prices of distant futures to levels well above their ranges of recent years. Meanwhile, despite the paucity of new discoveries of major oil fields, improving technology has significantly increased the ultimate recovery of oil from our already existing fields. Future balances between supply and demand will remain precarious and incentives for oil consumers in developed economies to decrease the oil intensity of their economies will doubtless continue. Presumably, similar developments will emerge in the large oil-consuming, developing economies.

The prospects for the Federal budget over the longer term remain troubling. With the baby boomers starting to retire in a few years and health spending continuing to soar, our budget position will almost surely deteriorate substantially in coming years if current policies remain in place. The enormous improvement of the Federal budget balance in the second half of the 1990s and early in the current decade was due importantly to the rapid growth in labor productivity during that period, which led to a vast but, in retrospect, temporary increase in revenues.

The Budget Enforcement Act of 1990 and the later modifications and extensions of the act almost surely contributed to the better budget outcomes as well, before the brief emergence of surpluses eroded the will to adhere to its deficit containment rules. The key provisions of the BEA expired in 2002 and no replacement has been adopted.

Reinstatement of a structure like the BEA would signal a renewed commitment to fiscal restraint and would help restore the discipline to the budgeting process, but it would only be a part of any meaningful endeavor to establish a framework for fiscal policy choices. The BEA was designed to constrain legislative actions on new initiatives. It contained no provisions for dealing with unanticipated budgetary outcomes over time. It was also not designed to be the centerpiece for longer-run budget policy. Importantly, the BEA did not set a clear objective toward which fiscal policy should aim.

Budget outcomes over the next decade will deviate as they always have from projections, perhaps significantly. Accordingly, it would be quite helpful to have mechanisms in place that assist the Congress in making midcourse corrections as needed. A well-designed set of such mechanisms would likely include measures that force a midcourse correction when estimated future costs for a program or tax provision exceed a specified threshold.

I do not mean to suggest that our budget problems will be solved simply by adopting a set of budget rules that restrain new legislation, even if those rules are augmented by effective mechanisms for making midcourse corrections. The fundamental challenge that we face is to come to grips with the adverse budgetary implications of an aging population and current health entitlements and with the limits on our ability to project the likely path of medical outlays.

The rapid increase in revenues during the 1990s significantly muted the necessity for making choices between high-priority tax and spending initiatives. In the context of an unprecedented increase in retirees, the need to make stark choices among budget priorities will again become pressing. Federal funding of access to advances in medical technology, for example, likely will have to be weighed against other spending programs as well as tax initiatives that foster increases in economic growth and the revenue base.

In 2008, just 4 years from now, the leading edge of the baby boom generation will reach 62, the earliest age at which Social Security retirement benefits may be claimed and the age at which about half of prospective beneficiaries have retired in recent years. In 2011, these individuals will reach 65 and will thus be eligible for Medicare. The pressures on the Federal budget from these demographic changes will come on top of those stemming from the relentless upward trend in expenditures in medical care. Moreover, projections of health spending are subject to extraordinary uncertainty. The reason is that we know very little about how rapidly medical technology will continue to advance and how those innovations will translate into future spending. Technological innovations can greatly improve the quality of medical care and can, in some instances, reduce the costs of existing treatments. But because technology expands the set of treatment possibilities, it also has the potential to add to overall spending, in some cases by a great deal.

Developing ways to deal with these uncertainties will be a major part of an effective budget strategy for the longer run. Critical to that evaluation is the possibility that as a Nation we may have already made promises to coming generations of retirees that we will be unable to fulfill. If on further study that possibility turns out to be the case, it is imperative that we make clear what real resources will be available so that our citizens can properly plan their retirements.

This problem raises a more general principle of public policy prudence. If, as history strongly suggests, entitlement benefits and tax credits once bestowed are difficult to repeal, consideration should be given to developing a framework that recognizes that potential asymmetry. A significant improvement in the budget in the 1990s reflects persistent efforts on the part of this committee and others. If similar efforts are made now, they should assist in preparing our economy for the fiscal challenges that we will face in the years ahead.

Thank you very much. I look forward to your questions.

[The prepared statement of Mr. Greenspan follows:]

PREPARED STATEMENT OF ALAN GREENSPAN, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. Chairman and members of the committee, I am pleased to be here today to offer my views on the state of the U.S. economy and current fiscal issues. I speak for myself and not necessarily for the Federal Reserve.

As you know, economic activity hit a soft patch in late spring after having grown briskly in the second half of 2003 and the first part of 2004. Consumer spending slowed materially, and employment gains moderated notably after the marked step-up in early spring. That softness in activity no doubt is related, in large measure, to this year's steep increase in energy prices.

The most recent data suggest that, on the whole, the expansion has regained some traction. Consumer spending and housing starts bounced back in July after weak performances in June, although early readings on retail sales in August have been mixed. In addition, business investment remains on a solid upward trend. In the manufacturing sector, output has continued to move up in recent months, though part of that rise likely reflected an increase in inventory investment. In the labor market, though job gains were smaller than those of last spring, nonfarm payroll employment growth picked back up in August.

Despite the rise in oil prices through mid-August, inflation and inflation expectations have eased in recent months. To be sure, unit labor costs rose in the second quarter as productivity growth slowed from its extraordinary pace of the past 2 years and employee compensation per hour remained on an upward trend. But, as best we can judge, the growth in profit margins of non-energy, nonfinancial, corporations, which, at least from an accounting perspective, had contributed significantly to price pressures earlier, has recently slowed. Moreover, increases in non-oil import prices have lessened—a development that, coupled with the slowing of profit-margin growth, has helped to lower core consumer price inflation in recent months.

Movements in energy prices have been a major influence on overall inflation this year. In the second quarter, gasoline prices rose rapidly as a marked pickup in gasoline demand strained refinery capacity and resulted in sharply higher profit margins. In May and June, refinery and marketing margins rose to levels that were 25 cents to 30 cents per gallon over typical spreads going into the summer driving season.

As a consequence of the steep run-up in prices, demand for gasoline eased, and an accompanying increase in inventories helped to reverse the bulge that had occurred in refinery and marketing margins. That reduction in margins resulted in a decline in the price of regular gasoline of about 20 cents per gallon despite the concurrent sharp rise in the price of crude oil. With margins having returned to more typical levels, prices of both gasoline and home heating oil are likely to reflect changes in crude oil prices more directly.

Evaluating the impact of rising oil prices on economic activity in the United States has long been a subject of dispute among economists. Most macroeconomic models treat an increase in oil prices as a tax on U.S. residents that saps the purchasing power of households and raises costs for businesses. But economists disagree about the size of the effects, in part because of differences in the key assumptions employed in the statistical models that underlie the analyses. Moreover, the models are typically based on average historical experience, which is dominated by periods of only moderate fluctuations in oil prices and thus may not adequately capture the adverse effects on the economy of oil price spikes. In addition to the difficulties of measuring the impact of oil prices on economic growth, the oil price outlook itself is uncertain.

Growing concerns about the long-term security of oil production in the Middle East, along with heightened worries about the reliability of supply from other oil-producing regions, led to a pronounced increase in the demand to hold inventory at a time when the level of world commercial oil stocks was rising only modestly. Some of that increased demand came from investors and speculators who took on larger net long positions in crude oil futures, especially in distantly dated contracts. Crude oil prices accordingly rose sharply, which, in turn, brought forth increased production from OPEC and induced some investors to take profits on long inventory positions. The resulting reduction in the speculative demand for inventories has, at least temporarily, reduced pressures in these markets, and crude prices have come off from their highs of mid-August.

Nevertheless, the outlook for oil prices remains uncertain. Higher prices have damped the consumption of oil—for example, U.S. gasoline consumption, seasonally adjusted, fell about 200,000 barrels a day between April and July. But the growing concerns about long-term supply, along with large prospective increases in demand from the rapidly growing economies of China and India, both of which are expanding in ways that are relatively energy intensive, have propelled prices of distant futures to levels well above their ranges of recent years.

Meanwhile, despite the paucity of new discoveries of major oil fields, improving technology has significantly increased the ultimate recovery of oil from already existing fields. During the past decade, despite more than 250 billion barrels of oil extracted worldwide, net proved reserves rose well in excess of 100 billion barrels. That is, gross additions to reserves have significantly exceeded the extraction of oil the reserves replaced. Indeed, in fields where, two decades ago, roughly one-third of the oil in place ultimately could be extracted, almost half appears to be recoverable today. Gains in proved reserves have been concentrated among OPEC members, though proved reserves in the United States, essentially offshore, rose 3-1/2 percent during the past 5 years. The uptrend in proved reserves is likely to continue at least for awhile. Oil service firms continue to report significant involvement in reservoir extension and enhancement.

Nevertheless, future balances between supply and demand will remain precarious, and incentives for oil consumers in developed economies to decrease the oil intensity of their economies will doubtless continue. Presumably similar developments will emerge in the large oil-consuming developing economies.

The remainder of my remarks will address the Federal budget, for which the incoming data suggest that the unified deficit has recently leveled out. With the economy continuing to improve, the deficit is more likely to decline than to increase in the year ahead.

Nonetheless, the prospects for the Federal budget over the longer term remain troubling. As yet, concerns about the budget do not appear to have left a noticeable imprint on the financial markets. In recent years, even as fiscal discipline has eroded, implied 1-year forward Treasury rates at long horizons, which history suggests are sensitive to changes in the fiscal outlook, have held fairly steady. Various measures of long-term real interest rates have also remained at moderate levels over this period.

These developments, however, do not warrant complacency about the fiscal outlook. With the baby boomers starting to retire in a few years and health spending continuing to soar, our budget position will almost surely deteriorate substantially in coming years if current policies remain in place.

The enormous improvement of the Federal budget balance in the second half of the 1990s and early in the current decade was due importantly to the rapid growth in labor productivity during that period, which led, both directly and indirectly, to a vast but, in retrospect, temporary increase in revenues. The Budget Enforcement Act (BEA) of 1990, and the later modifications and extensions of the act, almost surely contributed to the better budget outcomes as well, before the brief emergence of surpluses eroded the will to adhere to its deficit-containment rules. The key provisions of the BEA expired in 2002, and no replacement has been adopted.

Reinstatement of a structure like the BEA would signal a renewed commitment to fiscal restraint and would help restore discipline to the annual budgeting process. But it would be only a part of any meaningful endeavor to establish a framework for fiscal policy choices. The BEA was designed to constrain legislative actions on new initiatives. It contained no provisions for dealing with unanticipated budgetary outcomes over time. It was also not designed to be the centerpiece for longer-run budget policy; importantly, the BEA did not set a clear objective toward which fiscal policy should aim.

Budget outcomes over the next decade will deviate, as they always have from projections—perhaps, significantly. Accordingly, it would be quite helpful to have mechanisms in place that assist the Congress in making mid-course corrections as needed. Four or five decades ago, such mechanisms were unnecessary, in part because much of the budget was determined on an annual basis. Indeed, in the 1960s, discretionary spending, which is subject to the annual appropriations process and thus comes under regular review by the Congress, accounted for about two-thirds of total outlays. That share dropped markedly in the 1970s and 1980s as spending on retirement, medical, and other entitlement programs rose sharply. In the early 1990s, it fell below 40 percent, where it has remained over the past decade.

The rise in the share of expenditures that is not subject to annual review complicates the task of making fiscal policy by effectively necessitating an extension of the budget planning horizon. In the 1960s and early 1970s, the President's budgets provided information mainly for the upcoming fiscal year. The 1974 legislation that established a new budget process and created the Congressional Budget Office required that CBO provide 5-year budget projections. By the mid-1990s, CBO's projection horizon had been pushed out to 10 years.

Given the changing composition of outlays, these longer planning horizons and the associated budget projections were essential steps toward allowing the Congress to balance budget priorities sensibly. Among other things, this change has made the budget process more reliant on forecasting. To be sure, forecasting has become more sophisticated as statistical techniques and economic models have evolved. But because of the increasing complexity of our markets, the inaccuracy of forecasts—especially those that go beyond the near term—is a large problem.

A well-designed set of measures for mid-course corrections would likely include regular assessments of existing programs to verify that they continue to meet their stated purposes and cost projections. Although the vast majority of existing programs would doubtless be extended routinely, some that face appreciable opposition and offer limited societal benefit might not clear hurdles set by the Congress unamended, if at all. More generally, mechanisms, such as triggers, to bring the budget back into line if it goes off track should be considered, particularly measures that force a mid-course correction when estimated future costs for a program or tax provision exceed a specified threshold.

I do not mean to suggest that our budget problems will be solved simply by adopting a set of budget rules that restrain new legislation—even if those rules are augmented by effective mechanisms for making mid-course corrections. The fundamental challenge that we face is to come to grips with the adverse budgetary implications of an aging population and current health entitlements and with the limits on our ability to project the likely path of medical outlays. The rapid increase in revenues during the 1990s significantly muted the necessity of making choices between high-priority tax and spending initiatives. In the context of an unprecedented increase in retirees, the need to make stark choices among budget priorities will again become pressing. Federally funding access to advances in medical technology, for example, likely will have to be weighed against other spending programs as well as tax initiatives that foster increases in economic growth and the revenue base.

Because the baby boomers have not yet started to retire in force and accordingly the ratio of retirees to workers remains relatively low, we are in a demographic lull. But short of an outsized acceleration of structural productivity or a major expansion of immigration, this state of relative tranquility will soon end.

In 2008—just 4 years from now—the leading edge of the baby boom generation will reach 62, the earliest age at which Social Security retirement benefits may be claimed and the age at which about half of prospective beneficiaries have retired in recent years. In 2011, these individuals will reach 65 and will thus be eligible for Medicare.

The pressures on the Federal budget from these demographic changes will come on top of those stemming from the relentless upward trend in expenditures on medical care. Indeed, outlays for Medicare and Medicaid have grown much faster than has nominal GDP in recent years, and no significant slowing seems to be in the offing.

In 2003, outlays for Social Security and Medicare amounted to about 7 percent of GDP; according to the programs' trustees, by 2030 that ratio will nearly double. Moreover, such projections are subject to considerable uncertainty, especially those for Medicare. Unlike Social Security, where benefits are tied in a mechanical fashion to retirees' wage histories and we have some useful tools for forecasting future benefits, the possible variance in medical spending rises dramatically as we move into the next decade and beyond. As with Social Security, forecasting the number of Medicare beneficiaries is reasonably straightforward. But we know very little about how rapidly medical technology will continue to advance and how those innovations will translate into future spending. Technological innovations can greatly improve the quality of medical care and can, in some instances, reduce the costs of existing treatments. But because technology expands the set of treatment possibilities, it also has the potential to add to overall spending—in some cases, by a great deal. Other sources of uncertainty—for example, about how longer life expectancies among the elderly will affect medical spending—may also turn out to be important. As a result, the range of future possible outlays per recipient is extremely wide.

Developing ways to deal with these uncertainties will be a major part of an effective budget strategy for the longer run. Critical to that evaluation is the possibility that, as a nation, we may have already made promises to coming generations of retirees that we will be unable to fulfill. If, on further study, that possibility turns out to be the case, it is imperative that we make clear what real resources will be available so that our citizens can properly plan their retirements. This problem raises a more-general principle of public policy prudence. If, as history strongly suggests, entitlement benefits and tax credits, once bestowed, are difficult to repeal, consideration should be given to developing a framework that recognizes that potential asymmetry.

Re-establishing an effective procedural framework for budgetary decisionmaking should be a high priority. But it is only a start. As we prepare for the retirement of the baby boom generation and confront the implications of soaring expenditures for medical care, a major effort by policymakers to set priorities for tax and spending programs and to start making tradeoffs is long overdue.

The significant improvement in the budget in the 1990s reflected persistent efforts on the part of this committee and others. If similar efforts are made now, they should assist in preparing our economy for the fiscal challenges that we will face in the years ahead.

Chairman NUSSLE. Thank you, Chairman Greenspan. A number of things in your testimony hit a chord with me and particularly with regard to the fiscal management issues. I agree with a number of the points you made and we will continue to work with you and with those in Congress that want to try and work on these issues. The excuses are over with regard to the fiscal situation that we find ourselves in post-9/11. Those are all very important reasons why we find ourselves in the situations that we do right now. We needed to spend money in order to deal with homeland security and national defense and intelligence. I don't think anyone, or at least there are very few who voted against those proposals and very few in the country, who would have suggested that we should hesitate for a moment to fulfill those important priorities at the time they were made. But now is also the time to get back to that business of fiscal prudence, as you have said, and we will start that from this committee, as we did this last year with a freeze budget.

If I could, let me put up the first chart, which is with regard to the budget, talking about the surplus and deficits as a share of GDP. I am amazed to continue to hear and, for that matter, see the headlines of record deficits when it is comparing it with thin air, its nominal terms. Those are big numbers, but you have to compare them to something. My Visa card bill is—well, I know my wife may be listening, but something my wife and I have to manage and we usually can on a month-to-month basis, but for Donald Trump, it is probably not much of a heavy lift to manage our Visa bill. You have to compare the debt to something. And the deficit we have is compared to the gross domestic product. And if you compare it to that, you will see that not only is it not the worst, but if managed, as you said, it can be dealt with.

In fact, we did an analysis of where this deficit ranks in comparison to other post-World War II deficits, and it is not even in the top 10 of the years of deficits since World War II. That is not to mean that there is some excuse that we don't have to worry about it. I don't mean to suggest that at all. This committee has led on that issue. But it needs to be compared with the economy; and with that comparison, as a percentage of GDP, 2004 is only 3.6 percent as compared with 1983, which was 6 percent. So we have a long way to go before we are unable to manage it or before it is structural.

Second, let me say, one of the things that you didn't touch on, and I will touch, and that is managing for emergencies. We just saw our second hurricane. We have the possibility of yet another hurricane, and FEMA is underfunded. We will rush to the floor today an emergency supplemental because, yet again, Congress does not manage and does not prepare for emergencies that we know are coming and that we should begin to plan for. And I will continue to advocate for that. I know there are many in Congress who will continue to work to fund for these natural disasters that we hope and pray will not occur, but are always wrong in our hopes and our prayers.

Thirdly, let me turn to the economy. Let me read you some of these. I hear people talking down the economy and I want to read these. Real GDP grew at 4.7 percent over the past year. Payroll jobs have increased by 1.7 million. Jobs over the last 12 months, manufacturing employment rose by 22,000 in August alone and increased by 100,000 jobs in the past 6 months. Unemployment, as measured by the household survey, we have now grown the amount of people working in this country to 140 million in August. That is the most ever. Unemployment rate is down to 5.4 percent from last year in August of 6.3 percent. Manufacturing activities soared from the end of 2003 to the first half of 2004. It is the highest pace of manufacturing activity in 20 years.

Industrial production, the output of our Nation's factories, mines, and utilities is up 4.8 percent over the past year. Real business equipment investment rose up 13.7 percent. People are investing in the equipment, which production creates jobs. Housing starts and building permits have been running at their highest level in 20 years. And the home ownership rate is at a record high of 69.2 percent.

Chairman Greenspan, you said the economy has regained traction. I keep hearing people talk down the economy. Where is the bad news? Is there a number I am missing? I just read a number of numbers. But where are the numbers that say that the economy is heading in the wrong direction?

Mr. GREENSPAN. Well, Mr. Chairman, I think in any period of excellent or even moderate economic growth, you will find innumerable areas of our very complex economy which are doing poorly. And I think we will hear that this morning and I think that is important to recognize. But it is important, as you point out, to look at the overall scope of where the economy is going. And while as I pointed out earlier, we have moved into a soft patch, after very strong growth, subsequent to our meeting I think 6 months ago, despite that fact, the underlying structure of the recovery is still there. In my judgment, were it not for the very sharp rise in oil prices, we would be seeing some fairly strong growth, the strong growth typical of that earlier period. So we still have problems and there are innumerable problems, and I think I will address these problems later, but I think the economy is doing reasonably well.

Chairman NUSSLE. If the recipe is an energy strategy and, as you said, medical care costs and having some kind of predictability there, certainly we believe liability controls from frivolous lawsuits is an important issue. This committee has held hearings on not only tax cuts—reducing taxes is certainly a favorite pastime for many—but tax reform to unleash this burdensome and complicated tax system. These are areas I believe we can work on. But as far as the economy heading in a positive direction, I think it is very clear that from an overall standpoint, that is the case. We are not going to rest until people have jobs. That is part of the reason we are having this hearing today. But for political purposes, talking down the economy at this point in time does nothing to help our markets or our economy. And I would hope that people will start being specific in their proposals to fix this as opposed to just suggesting that we need tax increases.

With that, I will turn to Mr. Spratt and recognize him for any questions.

Mr. SPRATT. Mr. Greenspan, let me go back to the simple chart that I put up and explain what we have done here is adjust the CBO baseline. No. 1, I don't hope certainly we will have $115 billion a year recurring defense cost to add on top of the already enormous defense budget. We have assumed as a parameter that the tax cuts will not expire despite their written terms. And we have assumed with respect to discretionary spending that it will be current services.

The results are pretty dramatic, at least they are to me, $422 billion is the confirmed number this year; 361 doesn't take into account what we are likely to spend through FEMA for Florida next year. You could add easily another $10 [billion] to $20 billion on top of that. The deficit never dropped below $320 billion. It rises to $504 billion in 2014.

My question to you is are these numbers consequential? Can we take this fiscal path without some adverse effects that disrupt the economy, disrupt the growth of our economy, jobs, interest rates, and affect other things that are important to us?

Mr. GREENSPAN. I think not, Congressman. Were it not for the extraordinary problems we have in medical care and basically the fairly dramatic rise in the average expenditure per Medicare enrollee, we probably could live with the type of numbers you are projecting because the growth in the debt would not be all that large.

Having said that, it is very difficult to get around the issue, that when you look out into the period, especially in the years immediately following the end of your projection, you begin to get some very severe fiscal pressures coming because of the very sharp increase in retirement benefits from an ever-larger increase in retirees. The consequence of that, unless we address it, is a highly unstable, long-term fiscal situation. The one thing we can say with a degree of certainty is that the very large baby boom generation, which is currently working, will not be working in large measure in those years. And if you project that with any reasonable set of numbers, you get into a situation which suggests that current fiscal policy should try to keep the debt level down as low as we can, because we are going to be running into very severe pressures in the later years. And the better we are prepared in moving into that period, the more likely it is that we will address it in a rational and sensible way.

Mr. SPRATT. What form would the consequences take? Are much higher interest rates likely if we sustain this kind of debt?

Mr. GREENSPAN. That is correct. Federal Reserve studies have indicated over the years, and more recently in some fairly sophisticated analyses, that if you get to a point of fairly significant long-term structural budget deficits, it begins to impact on the level of long-term interest rates, which, in turn, of course, creates higher levels of interest payments and therefore higher deficits. And if you take the arithmetic progression, you can demonstrate that under certain scenarios that is an unstable situation. Obviously, we must not even get close to those types of scenarios, because if you get into that sort of debt maelstrom, it is a very difficult situation to get out of.

Mr. SPRATT. You mention in your testimony that we have not yet seen the financial imprint of these deficits in the financial markets. Is that because agents, foreigners, are buying most of our deficit today, holding most of our debt today, and it has not been a drawdown as yet on the domestic pool of capital and savings?

Mr. GREENSPAN. I think not, because were that the case, we would find that in corporate debt, we would be getting significant increases in long-term rates. And of course, we are not. I think that there is a general presumption out there that the longer-run problems in the deficit will get resolved one way or the other and the markets at this stage are not focusing on that as a materially difficult problem. I would like to add quickly, however, that I can't say how long into the future that would exist if we continue to fail to address what strikes me as a problem of potential instability.

Mr. SPRATT. You are telling us that there is a connection between high deficits and high interest rates that sooner or later comes to bear?

Mr. GREENSPAN. Yes.

Mr. SPRATT. Let me ask you with respect to the job market, our numbers indicate we are still 1.65 million jobs short of the number of private sector jobs that were in existence on January 1, 2001. This makes this recovery unlike any of the other nine recoveries in the postwar recessions. How do you account for the slow, sluggish growth in jobs given the amount of the fiscal stimulus that the Federal budget has been applying to the economy?

Mr. GREENSPAN. Congressman, the answer lies in two areas. We have had an extraordinary rise in productivity. Indeed, the rate of productivity growth itself has been rising over the last decade. This is unprecedented in the data that we have access to. This suggests that as demand picked up in the post-2001 period in a modest manner, the increases in efficiency, which in the longer run are obviously very beneficial to standards of living, was sufficient to enable businesses to meet their increased orders without hiring significant numbers of people and in many cases, even actually paring employment as their orders and sales and shipments rose.

Secondly, the recession that we had been through was the shallowest in the post-World War II period and consequently, you don't get a rebound out of the shallow recession.

So the combination of those two factors, the very major increase in efficiencies and the shallowness of the recession, statistically account for the major decline in employment. As the rate of productivity growth slows down, as it has recently, we are beginning to see the labor markets begin to pick up. And indeed, the report this morning by the Bureau of Labor Statistics on job openings—this is a new series—show a marked increase in private job openings indeed the series itself, which is also reflective of hires and separations, is consistent with a moderate rise in the establishment employment data.

Mr. SPRATT. Mr. Chairman, one last question so others will have an opportunity. You have testified before that the budget process rules we adopted in 1990 and 1991 and carried forward in 93 and 97, the PAYGO rules, the discretionary spending caps, the sequestration enforcement mechanism, all had a significant role to play in our budget successes of the 1990s. Do you still support and favor the reenactment of those rules in the original form and particularly the PAYGO rule which applied both the tax cuts as well as entitlement increases?

Mr. GREENSPAN. I do.

Chairman NUSSLE. Mr. Shays.

Mr. SHAYS. Thank you, Mr. Greenspan, for being here. You have made two points that we could add to the list that the chairman made. And one is he didn't cite the extraordinary rise in productivity. You also made the point that this is one of the shallowest recessions in recent history, which to me suggests that economic policy is headed in the right direction. I would like you to tell me, it is my understanding that productivity gains are one of the significant ways you increase wealth. Is that accurate or not?

Mr. GREENSPAN. In one sense, Congressman, it is the major way in which we increase real wealth. I am not talking about stock market values or anything, but about real assets and assets which enable the economy to produce ever increasing amounts of real goods for people to consume and to increase their standard of living.

Mr. SHAYS. How many months or years have we seen productivity growth in the United States?

Mr. GREENSPAN. The best way of evaluating it, we started with an annual rate of growth about 1, 1½ percent in the early 1990s, and the rate of growth has continued to accelerate to, most recently, in the 4 percent annual growth rate area.

Mr. SHAYS. I am talking about productivity. You are saying a 4 percent growth of productivity?

Mr. GREENSPAN. In the last number of quarters, with the exception of the last two. In other words, productivity growth has come off in the last couple of quarters, but it is growing. But the growth rate has been quite extraordinary for a number of years.

Mr. SHAYS. It strikes me as quite significant, particularly given September 11. I would love for you to talk about September 11, because it is my understanding we have lost over a million jobs. And I have met constituents of mine who have never recuperated from those job losses. So could you put some kind of perspective in terms of 9/11 and jobs?

Mr. GREENSPAN. Immediately after 9/11, we had expected a very significant contraction in economic activity, which seemed likely to be prolonged. Within a matter of weeks or a few months at the longest, it became quite evident that the economy had achieved a degree of resiliency which we had not suspected it had, and it stabilized reasonably quickly and started to grow again at a fairly modest but eventually accelerating pace. But also, remember we were in the tail end of a very protracted increase in the growth rate in productivity, which means obviously that productivity itself is accelerating. As a consequence of the increased efficiencies which tended to focus on how does one reduce costs and improve the value added of the economy, it turned out that the significant part of cost reduction, two-thirds of it, is invariably labor costs and therefore there was considerable pressure on labor costs. And indeed one of the reasons why the labor markets were so poor is that efficiency was so high.

It is an odd combination of events. Something which is extraordinarily important and good for the economy over the longer run was creating very significant problems for a number of Americans who were losing their jobs.

Mr. SHAYS. But we heard after 9/11 there were over a million jobs lost and a number of those didn't come back. It would be fair to say—and I don't mean 9/11, I call it September 11. The tragedies of September 11, had they not occurred, we could make a significant assumption that there would be significant or greater employment today; is that not true?

Mr. GREENSPAN. I don't know the answer to that. It is fairly apparent that the job losses, for example, in manufacturing, which are still not recovered, were the consequence of extraordinary increases in efficiency. So I have to assume, obviously, with the general weakness in the economy, that part of the job loss was there. But as the chairman pointed out in the GDP data, there was one quarter of decline and it wasn't a very large decline at that.

Mr. SHAYS. Thank you.

Chairman NUSSLE. Let me announce to my colleagues, I believe the floor is anticipating one vote on the previous question to a rule and then the rule we anticipate going on voice. So we will continue this hearing through the vote and members will be asked to come back as quickly as possible.

Mr. Moran.

Mr. MORAN. Thank you, Mr. Chairman.

Mr. Chairman of the Federal Reserve, I thank you for testifying. I ran for office in 1990, so I served 14 years and I have listened to you very carefully because you are a brilliant economist. But I have to say you leave me a bit confused as to where you really stand. In 1990, when I was running for office, there was an historic economic summit, and Bush senior made a tough decision. He decided to put in some real spending limits into the budget and to develop a course of the budgetary decision that would lead to it being balanced, and it started to work. I think it may have been his political downfall, but it was successful in terms of its objective.

President Clinton came in, an economic plan in 1993, not one Republican vote. It became a very partisan vote, but that led to a chart that I want the chairman to put back up. It is the chairman's own chart that I want to look at these dramatic increases during the Clinton administration and even more dramatic fall-off in economic growth in the first 3½ years of the Bush administration. The results were telling. But it seems to me it shows a dramatic difference in economic policy. That is what I am getting at.

On the one hand, President Clinton not only reformed the welfare program and did restrain spending, but he did increase taxes so he would at least get a balanced budget, a surplus, and then work his way toward a combination of investment and tax reduction. This administration's sole objective appears to be to cut taxes, and I don't see much else, because the PAYGO provision, which you had supported very strongly—I have a number of quotes of how much you felt that that played an instrumental role in budget balancing—has been thrown out. The PAYGO provision now only applies to spending. It doesn't apply to tax cuts. And while our ranking member asked you that, I want to find—I want to know from you which is the most responsible approach, because we have two vastly different approaches to economic policy. They have two vastly different results.

We debate on the floor of the House constantly between these two different approaches. It seems to me that results are quite telling, but I want you to tell us which you think is the most responsible. How important do you think it is not to have a balance between tax cuts, the PAYGO policy that applies to tax cuts, as well as spending.

Mr. GREENSPAN. Well, Congressman, if you are going to want a long-term strategy which seeks to have stability, a sense in which the whole budget balance process is sustainable over the long run, a necessary condition in my judgment is that you need a structure for making policy choices, a mechanism which enables you to choose between policy X and policy Y, but you cannot have both. The only way I can think of which has any practical possibility of working, which it has, and it has worked in the past, is a balanced PAYGO. I personally would much prefer to have lower taxes and lower spending but, of necessity, a balanced budget.

Others may choose higher taxes and higher spending. I think that that would make the level of economic activity less, but that is a debatable point. But choices have got to be made, and unless you have a structure which enables people in the House and the Senate to make those choices, I don't see how you come up with a credible budget

Mr. MORAN. So the structure, you are saying, is imperative. I am glad to have that clarified. The fact is that controlling the White House, the House of Representatives, the Senate, still the party in power has had an 8 percent annual spending increase, $30 billion of it attributable to homeland security.

Mr. SHAYS [presiding]. The gentleman's time has expired.

Mr. MORAN. OK.

Mr. SHAYS. Mr. Gutknecht.

Mr. GUTKNECHT. Thank you, Mr. Chairman. And, Dr. Greenspan, we are always delighted to have you up here. I appreciate the road-map that you have outlined.

I would share with you one of my favorite people from history. Winston Churchill once observed that Americans always do the right thing once we have exhausted every other possibility. And my sense is that when you talk about some of the real reforms that you mention, I really do think that this Congress will begin to take those more seriously as we go forward; among those, PAYGO and spending caps. And frankly, I am one who believes they ought to apply to both sides, and perhaps by next year we can reach a more bipartisan agreement on that.

Secondly, as a baby boomer, I was born in 1951. I think the demographics prove that there were more babies born in 1951 than any other year, and so we have a really strong vested interest in reforming Social Security and Medicare and making those systems look more like the market for health care and the way everybody else deals with retirement.

So there are a number of things we can and I think will do, but I would like to call up chart No. 13 and just because I think sometimes we need to put this in a bit of historical perspective. Can we call up No. 13? Because those who weren't here back in 2000 and 2001, in case we forget, just a little over 3 years ago, the Congressional Budget Office was projecting a projected surplus over the next 10 years of $5.6 trillion. OK? And as late as September 5, 2001, testifying before this very committee, the Congressional Budget Office projected that—this was after we had passed some of the tax cuts—that we would still have surpluses over the next 10 years of $3.4 trillion.

Now, I think history will record that they were wrong. No one could have predicted what happened just 6 days after they were here on September 5th. No one could have predicted those unanticipated expenditures. No one could have anticipated what would happen to the economy. I don't think anyone back then would have guessed we would say $47 a barrel oil.

I say all that just because I do think we have to put it in perspective, and if there is anything that has surprised me in the past 3 years it is how incredibly resilient the American economy really is. And I wonder if you would comment, because you touched on it briefly, have you or any of the economists that you have worked with put any kind of numbers to how much of a dampening effect $47-a-barrel oil has had? In other words, how much stronger would the economy be right now if oil were still down around $30 a barrel?

Mr. GREENSPAN. Congressman, it is difficult to tell, for reasons which I explore in my prepared remarks. Economists have been focusing on the consequences of oil price spikes for many years and have been puzzled by the fact that the average evaluation of what oil prices do to GDP, when you look at the full spectrum of price change, most of which is at lower levels and small changes, if you extrapolate that, you don't get anything which resembles the type of economic weakness that we tend to see. So that we suspect that there are elements involved when oil spikes occur that, say, impact confidence in one form or another, which have impacts on the economy which are difficult to evaluate.

I don't think anybody has a number which I would feel comfortable with. In other words, I know it has an effect. I know it is there, and I am almost certain that at $30 for oil, we would be doing better than we are today, but by how much I think is extraordinarily difficult to judge.

Mr. GUTKNECHT. Well, Mr. Chairman, I would hope that if you get a chance to talk to our friends over in the Senate, we are a few votes short of passing a comprehensive energy bill over there, and I think if there is one thing we can do before we go home in October, if we could pass comprehensive energy legislation and give confidence to the markets that we are serious about a long-term strategy to deal with energy prices, it strikes me that that would have a very positive psychological effect, if nothing else, on the American consumer as well as American business. Would you like to comment on that?

Mr. GREENSPAN. Well, I think there are a lot of elements within that energy bill which are very important, good, and should be enacted, and others which I would suggest are otherwise.

Mr. GUTKNECHT. Well, I think we can compromise on those things; and, frankly, the bill that passed the House was probably a little larger than it needed to be, but I think there is room for that.

Again, I want to thank you, and I hope you will continue to speak out on budgetary reform, on Social Security reform, on Medicare reform. I think these are all very, very important issues whose time is clearly coming. Thank you very much.

Chairman NUSSLE [presiding]. Ms. Hooley.

Ms. HOOLEY. Thank you. Thank you for being here. I appreciate your comments.

We have talked a lot about PAYGO, whether or not it should cover just tax cuts—rather, should it just cover spending, or should it cover both tax cuts and spending. You look at what the numbers show where we are going to be in debt in 2014. I am incredibly worried about what our economy is going to be like in the future. Right now in Oregon, the average wage is down $3,000, cost of living up. Poverty is up. We have less people on health insurance. So I am very worried about what our economy is in the future.

In 2010, all the tax cuts will expire. Other than the PAYGO rule that would cover both tax cuts and spending, what do you see as a framework for our economy in the future? And knowing Congress as well as I do, I can't imagine that we are going to let those tax cuts expire, which is going to add to our deficit. What do you suggest we do in regards to tax cuts that are expiring in 2010? We haven't dealt at all with the alternative minimum tax, which is impacting more and more people every year. What is your suggestion on PAYGO?

Mr. GREENSPAN. Well, Congresswoman, the reason I think it is important to get a policy structure in place before you try to get at the substance of trade-offs is that you have to have rules which require you to choose between high-priority items. In other words, largely as a consequence of the acceleration of productivity and increasing revenues, we have lost the ability to realize that we have to make choices, and the choices are between two things, both of which have exceptional value to the economy, to the society or to particular constituents. The trouble is we cannot continue to just go on without saying we can have this but not this, and PAYGO embodies that mechanism. But that is only for new initiatives, as I point out.

What we need in addition, so far as I am concerned, is some form of ongoing structure such as triggers, for example, which would be applied to specific programs which would require that in the event that they veer off projected courses of cost, that they get automatically readjusted, or at least there is a mechanism which restructures those particular programs.

Unless you have got the decisionmaking structure in place, I don't see how you can take the huge budget that we have and try to make the determination of what is important and what is not, unless you break it down into specific decisions. Once you do that, I do think you have the capability. But in answer specifically to your question, I would say PAYGO is a sufficient mechanism to make the types of decisions you are asking.

Ms. HOOLEY. Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman.

Chairman Greenspan, we have heard a lot today about the deficit, and obviously most of us believe it is too large, although obviously in terms of the size of the economy, historically it ranks about 12th or 13th.

There is a big debate that is ensuing today about whether tax relief is part of the deficit problem. As I look at the numbers, I see in the fiscal year 2005 budget that the House passed, we passed $153 billion of tax relief compared to $13.1 trillion of spending, and if I do the math correctly, the tax relief is approximately 1 percent—1.2 percent to be exact—of the spending, which would lead me to conclude that it is very difficult to make the case that somehow the deficits that we have today are tax-relief driven.

I also believe that for some reason the tax relief was a line item in our budget. Say, for example, if it was a line item for the widget production reformation administration, that many in this committee would instead propose increased funding for that line item; but somehow when we let taxpayers keep more of what they earn, it somehow is a major driver of the deficit.

Another observation I have—and I am curious whether you have seen the same figures—but under a static analysis, I guess it would suggest that the tax relief would cost us roughly 1 percent of the Federal budget; but instead, the latest reports I see from Treasury indicate that revenue is actually up since we passed the latest round of tax relief. Reports I have seen have shown that the Treasury has collected $70 billion more for the first three quarters of fiscal year 2004, over the first three quarters of fiscal year 2003, a 6.3-percent increase, seemingly suggesting that at least in this particular case, that maybe tax relief did help ignite an economic recovery that has added revenues to the Treasury and actually helped become part of the deficit solution as opposed to part of the deficit problem.

So my first question is, have you seen these reports from Treasury, and do you concur that revenues are up now over what they were a year ago?

Mr. GREENSPAN. Well, Congressman, I think the general conclusion about the fact that revenues are lower than they would otherwise be without the tax cut, but higher because of the tax cut, is best described by saying that a tax cut will immediately lose revenue, and then to the extent that it increases economic activity and generates a larger revenue base will gain some of it back. It is very rare, and very few economists believe that you can cut taxes and you will get the same amount of revenues. But it is also the case that if you cut taxes, you will not lose all the revenue that is implicit in the so-called static analysis.

Mr. HENSARLING. Let's examine the spending side of the equation. I believe in our lost budget, the Federal—the Federal budget rose by over 3 percent, roughly twice over inflation, which, compared to recent trends, is actually an improvement. Many have argued again that these are tax relief driven deficits; yet I know that the Democrat substitute budget that was offered contains $135 billion more spending. There were at least 31 amendments offered in budget markup to increase spending, and I am curious about the role of spending in the deficit equation. And as our chairman pointed out recently, the House had an opportunity to vote on a number of budget enforcement mechanisms, including spending caps, rainy day fund, a version of enhanced rescission or a legalized version of the line-item veto.

To what extent does spending play a role in the deficit, and how much have we been set back by voting down these various spending restraints?

Mr. GREENSPAN. I don't know, but I have testified before that I think there is a fairly significant constituency for tax reduction and a fairly significant constituency for spending increases, but none that I can find which is in favor of reducing the deficit. And the only way you can reconcile this process, in my judgment, is to bring PAYGO and a number of other structural elements back in the decisionmaking process, so that you can actually debate between two programs rather than try to introduce both.

Mr. HENSARLING. Thank you, Mr. Chairman. My time is up.

Chairman NUSSLE. Mr. Moore.

Mr. MOORE. Thank you, Mr. Chairman.

Mr. Chairman Greenspan, thank you for being with us. We have in this country a $7.3 trillion national debt, a deficit for 2004 of $422 billion. Interest for 2004 is projected to be about $322 million, not quite, but almost, a billion dollars a day; and by 2006, it is well more than a billion dollars a day interest on our national debt. Is that basically correct so far?

Mr. GREENSPAN. It sounds fairly accurate, yes.

Mr. MOORE. I speak on a fairly regular basis to high school and college students, and last week I spoke to a group of high school students in a government class. And I told them what I just told you about our deficit and our debt, and I said to this class, why should you even care about the $47.3 debt? A senior girl raised her hand and said, "Because we are going to have to pay it off."

Well, good luck. And I tell students when I talk to them about this, "You should be angry at Congress for what Congress is doing to you and future generations in this country."

You have already testified, Mr. Chairman, that in 2008 the first wave of the baby boomers begins to retire. Is that correct?

Mr. GREENSPAN. That is correct.

Mr. MOORE. Alright. You have heard the term "Social Security Trust Fund." is there in fact a Social Security Trust Fund where money is segregated for Social Security, not used for any other purpose?

Mr. GREENSPAN. Well, the answer is no, and this gets to the question of the difference between the $7.3 billion that you point out which is——

Mr. MOORE. Trillion.

Mr. GREENSPAN. Trillion—which is the public debt and a figure of roughly $4 trillion which is the debt to the public.

Mr. MOORE. I understand.

Mr. GREENSPAN. And the counsel for the unified deficit essentially assume in effect that there is no separate trust fund in which there are segregated revenues, because obviously we use general revenues to pay for Social Security and everything else.

Mr. MOORE. Yes, sir. In fact, right now Social Security revenues are being used for other purposes as well. Isn't that correct?

Mr. GREENSPAN. Well, the difference between Social Security tax receipts and benefit payments are obviously going to finance other aspects of the Federal budget.

Mr. MOORE. Yes, sir. And I believe by your testimony—but I want to ask you the question—do you have concerns about my children—I am a baby boomer, I am going to retire in the not-too-distant future—about the rest of America's children providing for the baby boomers' retirement, servicing the debt, paying down the debt, if that is at all possible? Are we putting America's children in a financially or economically unsustainable position in the future with all of those burdens?

Mr. GREENSPAN. Congressman, I don't know the answer to that question, but the fact that I don't disturbs me.

Mr. MOORE. Me too.

Mr. GREENSPAN. In other words, I cannot say with any degree of confidence that we have not made commitments which we cannot deliver. And unless and until we are in a position where we can say we have not made these commitments, we do not know the resources will be available to meet the needs of retirees but also the needs of workers who will be presumably requiring, as their parents and grandparents had, a rising standard of living.

Mr. MOORE. I practiced law for 28 years before I came to Congress, and under Kansas law attorneys were required to have what is called a trust fund to segregate their own funds from their clients' funds. And you have heard about that, I am sure. And it is an absolute no-no for an attorney to violate that and to use a—to commingle the clients' funds with his or her own funds. That is what a trust fund is about. Correct?

Mr. GREENSPAN. That is what it is in the private sector.

Mr. MOORE. That is not the way it is in Congress, is it?

Mr. GREENSPAN. It is not.

Mr. MOORE. And in fact, there is no Social Security Trust Fund, as we discussed, because those funds are commingled for general revenues and used for whatever purpose Congress deems necessary. Is that correct?

Mr. GREENSPAN. Well, that is what happens in the budgeting process, yes, sir.

Mr. MOORE. Would there be any advantage to actually establishing a Social Security Trust Fund? You remember a few years ago we talked about a lockbox, and the lock seems to have gotten picked. And we talked about the possibility 3 or 4 years ago about maybe starting to pay down debt. And there was even concern about paying down the debt too soon. Well, we sure took care of that problem, didn't we?

Mr. GREENSPAN. Yes, sir.

Mr. MOORE. Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Thornberry.

Mr. THORNBERRY. Thank you, Mr. Chairman.

Chairman Greenspan, as I listen to your testimony, I am struck, among other things, about the role of uncertainty and the possibility of external events and how they can impact our economy. You talked about energy. It doesn't take a great imagination to think of some event in the Middle East or in South America that could aggravate energy prices substantially and have enormous consequences for our economy.

Certainly the attacks of September 11, had enormous consequences for our economy. Part of what we have been trying to do is pursue those defense and homeland security policies that prevent future attacks or limit them as much as possible. But I want to ask you, because I am sure you have thought a lot about how best to insulate our economy from the consequences of some future terrorist attack. We know that the terrorists are targeting in on our economy. They have said so, and it is clear that they see that as a way to hurt us. You said earlier that after September 11, our economy seemed more resilient than you thought it would be in bouncing back, which is encouraging, of course; but have we taken the steps you think are needed to help minimize, I guess, the economic consequences of some future attack, should that occur?

Mr. GREENSPAN. Well, Congressman, extending our experiences of 9/11, it is fairly apparent that what helped us during that period and immediately thereafter was the extraordinary amount of flexibility in both our financial and product and labor markets. We had the ability to absorb shocks and rebound. I have argued in many forums in recent years that a great part of that flexibility has come from increasing globalization and very specifically our part involved in it from a bipartisan deregulation of our economy generally, which started in the 1970s and has essentially preceded more or less to this day, and, of course, the extraordinary advances in technology which have many causes but have been a major factor in the American economy.

The difficulty is that an economy such as ours is based on voluntary actions of people acting largely on bilateral trust. People have created wealth by interacting, and what terrorism does is to induce fear and withdrawal. And if you withdraw from the specialization of labor, as economists like to put it, the GDP comes down. And so the question essentially is how do we create a sufficiently flexible system so that, short of remarkably large terrorist attacks, we can recover?

I think we did that inadvertently. We didn't do it as a part of an antiterrorism economic policy. We lowered our tariffs. We increased globalization. We deregulated the airlines. We did transportation deregulation in general. We did a large number of things, especially in the financial area. All of those things, while not directed at the issue of terrorism, per se, have been the reason why I think we do have a degree of flexibility, which means that short of very large impacts, our economy will recover.

Mr. THORNBERRY. And as that applies to us, steps that we might take that would go back on regulation or diminish the globalization or the contacts or diminish the flexibility in our economy, it would make it more difficult to recover?

Mr. GREENSPAN. That is what concerns me most. I am most concerned about protectionism, largely because if we start to remove the international flexibility that has developed in recent decades, I think the rigidity, the calcification of our economy would get to a point where it could be quite vulnerable to terrorist attacks.

Mr. THORNBERRY. Thank you.

Chairman NUSSLE. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman.

Nice to see you again, Chairman Greenspan. Considering that we all take such great satisfaction in what it is that you have to say, and I follow it closely every single day, and certainly you are without peer as it relates to reflecting on the state of markets across not only America but the entire world, I am just going to refer to you from now on as, "Your Excellency" with your commentary.

Now, let me ask you a couple of questions based on observations. I think you would agree that we are fighting two wars with three tax cuts.

Mr. GREENSPAN. I can count, but I don't know what I am counting necessarily.

Mr. NEAL. Would you acknowledge, based upon your suggestion back in February, that the Budget Committee considered cutting Social Security because of the budget situation and demographic pressures caused by the imminent retiring of baby boom generations? Would you acknowledge that the Social Security Trust Fund, or the financial status of Social Security has been weakened by a decision to yank $2.3 trillion out of the budget over the next 10 years?

Mr. GREENSPAN. Congressman, as I indicated in my prepared remarks, Social Security is out of balance and will require certain adjustments, either on the tax side or on the benefit side or in a number of other related areas.

The problem that I have is that everyone acknowledges that there is a gap, but no one agrees that anything that will close the gap is acceptable.

Mr. NEAL. Except, Mr. Chairman, we did take $2.3 trillion out of the budget over the next decade. Has that strengthened or weakened the Social Security program?

Mr. GREENSPAN. I don't know how to answer that, largely because I think that the Social Security program should stand on its own. And if you have a system in which there are and should be trust funds, those revenues, as it was indicated by one of your colleagues, in my judgment, ought to be segregated.

Mr. NEAL. Mr. Chairman, let me follow up on that. We are in the midst of a war in Iraq, as we would all acknowledge, and Lawrence Lindsey, the President's chief economic adviser at the time, said it might cost up to $300 billion. That looks now as though it is going to be a low figure. He lost his job for saying that.

My point is that we have a natural disaster occurring in Florida as we speak where there is going to be up to $40 billion or more required to help those folks out, deservedly so. We are in the midst of an international crisis fighting a war in Iraq and fighting a war in Afghanistan, with troops stationed in Bosnia and Haiti. We have increased defense spending by significant numbers, as an overwhelming majority of this Congress voted for, myself included, and we have all acknowledged that there have been downturns in this economy, bumps along the road. And then we hear that Social Security has problems, that Medicare has problems, and we fail to connect the dots between the problems that we have and the obligations we are going to have. And the $2.3 trillion that has been yanked from the economy over 10 years strikes me as being irresponsible.

Now, there were a number of things that we did in the 1990s that took some courage, Bush I, Clinton twice, a majority of Congress, including the Republican leadership for the most part, that voted for those positions; certainly the Republican leadership in the Senate voted for those positions. And now we find ourselves back in a situation with a mounting deficit, international obligations that are going to incur huge costs for the American people, Social

Security position that has been jeopardized, money for Florida, and we hear about a trip to Mars. Can you do all of this with the tax cuts that we have embraced?

Mr. GREENSPAN. Well, Congressman, I think you have made the case for restoring PAYGO. Those types of problems that you assert would exist, if the Congress agreed with your priorities, would not exist if we had a mechanism in which the Congress was forced to choose between A and B rather than just go along, doing both A and B.

Mr. NEAL. I will go back and reread your comments to seek that clarity. I want to say this, lastly. There is a clever game that is played here, as you know very well, and that is Members who preach fiscal responsibility run to the appropriators faithfully asking that their favorite program be funded. The easiest way, as Mr. Nussle and I have discussed in the past, to perhaps speak to the issue you have raised is to publish the letters of those who ask for spending. Put it out there. They go back to the appropriators. They ask for money, and then they go back home and preach fiscal discipline, at the same time Mr. Nussle and I discussed, they attend groundbreakings and ribbon cuttings.

Thank you, Your Excellency.

Chairman NUSSLE. The gentleman's time has expired.

I am going to try this. Please listen to my unanimous consent request that the chairman has to leave at 12:30 as I have stated. I will ask unanimous consent that all members be allowed to question the witness for 3 minutes so that we have more members that are allowed to question. I ask unanimous consent that we be allowed to do that. I know that is unfortunate, but I want to get in as many as possible.

Without objection, so ordered.

The gentleman from Pennsylvania is recognized. Unfortunately, only for 3 minutes.

Mr. TOOMEY. Thank you, Mr. Chairman. And let me commend my colleague Mr. Neal for a very constructive suggestion he made at the end of his questioning.

Chairman Greenspan, thanks for being back. My question goes to what I sometimes think of as some of the self-inflicted wounds that we have with respect to our economic challenges, and one that comes to my mind is the ongoing problem of excessive litigation. I say self-inflicted, because of course the political establishment currently tolerates a system—a legal system that I think in some ways has actually run amok. The Rand Institute for Civil Justice estimates that litigation and settlement expenses cost as much as $60 billion since 1982. Two Council of Economic Advisers estimated in April of 2002 that the U.S. tort system consumes 1.8 percent of GDP, double the average cost of other industrialized nations.

Another way of looking at is they estimate that excessive tort claims are equivalent to a 3 percent tax on wages or a 5 percent tax on capital income.

My question for you, Mr. Chairman, No. 1, do you believe that tort claims are excessive, and to the extent that tort claims are economically excessive, do you believe that they are equivalent in some ways to a tax on individuals or business?

Mr. GREENSPAN. Well, Congressman, a judgment as to whether they are excessive or not depends essentially on what you are trying to do with your tort system. Clearly, a capitalist market economy cannot function unless there is a rule of law, and that contracts need to be protected, and we need a structure of law which enables individuals to address wrongs both from the business sector and from business reasons and otherwise.

It is also clear that if everybody who has a legal right to move into adjudication were to do so, the court system, our legal system, would be swamped into immobility. And so it is clearly a system which implicitly requires voluntary restraint on expansion of it. Where that line is, I don't have a judgment.

Mr. TOOMEY. I understand that. Let's for a moment assume that to the extent that there were to be an excess beyond what is appropriate and necessary, could it be described fairly as equivalent to a tax?

Mr. GREENSPAN. It would have the same effect.

Mr. TOOMEY. It would have the same net economic effect as a tax, which is, of course, to curb economic growth?

Mr. GREENSPAN. Well, I just want to speak in general terms, because there are differences in the incidence of those particular types of actions, but it has an economic impact which is similar to a tax.

Mr. TOOMEY. Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Edwards.

Mr. EDWARDS. Mr. Chairman, following up on your testimony over the past year, it seems to me once again Congress has made the mistake of listening to your goal of lower taxes in the long run, but totally ignoring your strong recommendations to have pay-as-you-go rules for new tax cuts and for new spending increases. Consequently, we are facing $422 billion deficit over the fiscal year 2004, and my concern is that Congress is going to, once again, do this year what it did last year. It is going to listen to your advice about overall it would be nice to have lower taxes, but I wouldn't bet a dime of my family's net worth that Congress is going to put strict limits on Medicare and Social Security expenditures. If anything, this Congress, through its leadership, just invested another $550 billion of taxes for those purposes.

My question to you is in your testimony you talked about if we don't make major policy changes and we continue down this road of increasing deficits that ultimately it could lead to—and I believe you used the word instability.

My question to you is would you define instability in the worst case scenario as you define it, and also how you would define a more moderate level of instability if we keep going down this path of ever-increasing national deficits?

Mr. GREENSPAN. Congressman, I think you make a good point in making certain that these definitions are exact and not general. The ultimate instability is the case I described earlier where you get to a point where the budget deficit is large enough and therefore adding to the national debt, which in conjunction with rising interest rates because of that creates an unstable statistical or arithmetical system which leads to a major breakdown of the fiscal system.

Now, that has happened in the past, not obviously in the United States, but we have cases in other countries over the generations where that has happened. We are nowhere near anything resembling that, as evidenced by the fact that there is no inflation premium of any significance in our monetary system, but it is certainly conceivable that if we wholly disregard fiscal restraint and merely go on our way of, as I said before, advocating ever-increasing deficits, which is the implication of a lot of the actions that we take, then I think we start to risk problems.

The situation that probably most in a practical sense we need to avoid is not an unstable breakdown of the system but significantly higher rates of inflation and of inflation premiums embodied in long-term interest rates, and what we used to call—I guess we still would—stagflation. And that is what lies in front of us if we don't restore balance to our fiscal processes.

Mr. EDWARDS. Thank you.

Chairman NUSSLE. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman.

Chairman Greenspan, we are glad to have you here today. My question is, I notice when you mentioned in trying to control the expansion of government, one would be using PAYGO, and you mentioned that by using it to increase appropriations, you ought to find some other way to cut. But you used the same example for tax cuts, and I was just curious as to the money coming in from the people is certainly their money already, and just to take less, we need to make an offset. Tell me how you would do that.

Mr. GREENSPAN. Well, Congressman, I, as I indicated earlier, would prefer both lower taxes and lower spending. What I would not think is desirable is spending with borrowed money, which is what the issue is. If you are going to lower taxes, you shouldn't be borrowing essentially the tax cut; that over the long run is not a stable fiscal situation.

Longer-term growth, in my judgment, is probably maximized by keeping the level of expenditures low and therefore having the capacity to keep taxes low, which, as far as I can judge, would probably, from a fiscal policy point of view, create maximum economic growth and sustainability.

Mr. BROWN. If I could follow up, then, the multiplied effect of the tax cuts should be sufficient enough, I think, to absorb any deficit because of the spending in the private sector?

Mr. GREENSPAN. That may be the consequence, but all of the evidence is that does not happen to be the case. That is, as I mentioned before, it is true that when you cut taxes you gain some revenue back—we don't know exactly how much it is, it is not small, but it is also not 70 percent or anything like that; so that we do know that if you cut taxes, you will increase the deficit, but by not as much as the tax cut.

Chairman NUSSLE. Mr. Ford.

Mr. FORD. Thank you, Chairman Greenspan and Mr. Nussle.

Real quick, Mr. Chairman Greenspan, I know my time is short, there seems to be a big disconnect. I heard Chairman Nussle and others talk about these numbers and this growth, and I heard all this talk about tax cuts and not adding to the deficit. But I think we forget there are more people living in poverty today than there were 3 years ago. We can put all the numbers and talk about growth here and growth there. People have seen increases in property and in State and local taxes. People are seeing their light and power bills go up because of, as you talked about, the uncertainty of oil prices. And I think at some level we have to be willing to take some responsibility for tuition increases at the University of Alabama and University of Tennessee. We have seen a 60 percent increase over the last 3½ years at our State schools across the State.

Mr. Nussle mentioned that more people are working today. Sure there are, but there are more people living today in America than there were 3 years ago, so one would expect that number to increase.

I have heard you talk about the entitlement challenge and how that crushing blow to my generation, other younger Americans will face here in the coming years, and you have talked about how we have got to get our arms around it. Do you believe we should raise the eligibility age, No. 1? And should we means test entitlement programs before we, perhaps, rush down the path that some have suggested in terms of a new ownership society and privatizing parts of Social Security?

I have only got 3 minutes, Mr. Chairman. I hate to be rude to you, but I wanted to ask one more to you as well.

Mr. GREENSPAN. Well, Congressman, I would basically say that there are choices of how one confronts this problem, and that is the purpose of having a process such as PAYGO or other structural additions to the budget process.

Mr. FORD. What do we say—and we are Democrat and Republican up here who have got this problem. The people we point to, jobs being created, we all know the data shows that people are making less money than they were before. What do we say to those who say, you guys are cutting taxes and middle-class people now pay more, if I am not mistaken, a higher percentage of their income in taxes than those of us in the top 1 percent, what do we say to those people?

We have said now for 2 years—I was here when the President's tax plan passed and he promised this and he promised that, and those things just have not happened. So what do we say? Just keep waiting, and those at the top 1 percent will enjoy a bigger tax cut and bigger benefits, and those of you who are struggling to send your kids to college and pay gasoline prices and pay higher property taxes, you guys hang in there, because we are turning the corner and better days are coming? Should we just continue to say those things?

I would even ask my friends on the other side, because I know we are not alone in here in these things—Mr. Gutknecht, you talked about some of these things in your questioning. You have to be hearing the same things. You promised and others promised that this tax cut would produce all these wonderful things. I wish I could sit here today and say I was wrong, but unfortunately the numbers, as much as we try to put a spin on these things, we have got a $422 deficit, and we are here bragging about it. We have got more people living in poverty today. Health care premiums are going up for people, and we are sitting here acting as if we have done something good for folks.

So I am just curious. Do we keep telling them that we are turning a corner and that good times are coming, or is there something else that we should be saying? Now, I understand all these numbers and all, but I am just curious, what else should we be saying to everyday folks?

Mr. GREENSPAN. Well, I don't think it is what we should be saying. It is what we should be doing. And I think the problem is a broader question. One issue on which I have testified previously, relates to the fact that we have had a very significant increase in skill differentials. People who have gone through college and graduate school have a significant and increasing wage premium compared to those who have gone to high school or less. We have got a problem in this country in which the distribution of wealth and income is getting increasingly concentrated. This is largely because our educational system has not, in my judgment, been up to the task to sufficiently bring up our younger children through primary and secondary education and through high school and college so that the supply of skilled workers increases relative to demand, so that those wage premiums go down and the increasing concentration of income slows down. I have argued that we have to confront this issue, and unless and until we do, we have some very serious problems. It is not what we say to people, it is what we do to resolve these types of problems.

Chairman NUSSLE. Thank you, Mr. Ford. That may be one of the most important statements you have made all day. I appreciate it. Mr. Bonner.

Mr. BONNER. Thank you, Mr. Chairman. And before I address the chairman, I would just like to say to my friend from Tennessee, if the people of Tennessee are paying 60 percent more to attend the University of Tennessee today than they were 3 years ago, they ought to come to the University of Alabama. They can get more for their money.

Mr. FORD. Mr. Chairman, I will let that one slide till late September, Bonner.

Mr. BONNER. Mr. Chairman, we have talked a lot about manufacturing job loss and higher productivity in this country. If I am not mistaken, other countries have seen job losses as well. Japan, China, Brazil and other countries have seen increasingly alarming job losses and many have also seen increasing productivity levels as well, although not to the extent of the United States.

I have contended since I first came to Congress 20 years ago as a staffer, and certainly feel so today as a Member, that as a Nation we do a very poor job of trying to grow the economy or grow jobs when we place burden after burden after burden on business and industry, from the rules that come out of the various agencies and departments, to our very tax system. And so my question to you is related to one of the discussions I think we will be having during this election season and that is not necessarily tax cuts but tax reform.

Have you ever taken a public position about whether we could simplify our tax system to make it less burdensome on business and industry so they can go out and create more new jobs as opposed to what has happened in the last few years?

Mr. GREENSPAN. I must say I thought the 1986 Tax Act was what most economists would consider an ideal system in our political context. We initiated that, and then observed year after year as it began to deteriorate and return to what it eventually looked like prior to the 1986 act.

It strikes me that as with all programs that deteriorate, we have to go back and refix them, and probably we continually do that every 20 years or so. I think what we need is what we had. I thought that was an extraordinarily sensible balance of priorities in the country, and as I recall, it was reasonably well accepted by our society. Let's try it again.

Mr. BONNER. Thank you very much.

Chairman NUSSLE. Mrs. Capps.

Mrs. CAPPS. Mr. Greenspan, to continue Mr. Ford's line of thinking, you are dead on, dead right with respect to the importance of education to our economic future, I believe, and particularly to the future of our now underachieving youth. Would that mean, perhaps, that we have to make resources available at the Federal level, and would that might mean we might have to reconsider other priorities, including tax cuts?

Mr. GREENSPAN. Well, this is the reason why I am so strongly in favor of getting a structure in which the Congress can debate these choices and decide where our limited resources go. And I can't tell you what this committee ought to come up with, but it is essentially the charter of this committee to make these very broad judgments and to try to reflect the value systems of the American people and what their trade-offs are.

Mrs. CAPPS. Let me try that from another angle, and I agree with you we ought to be tackling this.

You made it clear, for example, on numerous occasions that you think cutting taxes in tandem with spending cuts does increase economic growth, but this is kind of a King Solomon tack on it. Which is preferable, unfunded tax cuts and large deficits or no tax cuts and balanced budgets?

And maybe to illustrate, President Reagan in 1982 realized that the full scope of his tax program would have dire consequences for the fiscal health of the Federal Government, and so he signed into law a bill which scaled back some of his tax cuts. Was this a good idea or not? That is the question.

The Bush administration has shown some flexibilities by having sunset dates. That might be what we might call a trigger effect, and given that the majority—now the Republican leadership has not dealt with this, as you have just indicated—would it be better to let some tax provisions lapse rather than to make them permanent at the cost of continuing such large deficits which make it hard to pay for education?

Mr. GREENSPAN. Well, I have always said before you start any fiscal policy, it has got to be balanced in some form or another, and that is the reason why I think structure is important. I personally, were I a member of this committee, would probably be consistently voting for lower taxes and lower spending, but there are many more members in this committee than any individual, and fortunately what this committee tends to reflect, and indeed the House of Representatives more generally, is where the American people are, where their trade-offs are and where their choices are.

I can tell you that if we cut taxes, we will, other things equal, increase economic growth and ultimately the revenue base in a way which, without getting into the numbers, general growth would be very substantial.

I think that is a very important thing to do, but I fully recognize that there are others who would prefer alternatives, where longer-term growth, which is a function in my judgment of tax policy, is longer term, and other people would prefer, say, shorter-term programs because they have very specific issues to deal with. I don't know how you trade that off, except by a PAYGO type of discussion.

Mrs. CAPPS. You keep coming back to that. Thank you very much.

Chairman NUSSLE. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman.

I thank you, Chairman Greenspan, for being here. As you know, our Federal education funding through this committee has actually increased dramatically during Ms. Capps' tenure, partly because of her, I suppose; a 49-percent increase over the last 3½ years. So it is not for lack of funding, but it is obviously a balance, as you said.

The deficits that we have heard as record deficits, I tell you when I was elected and ran 12 years ago, our deficit was 4.7 percent of the GDP. This year we hope it will be about 3.6 percent, maybe a little less, and it is projected to go down. The economy you talked about, Chairman Greenspan, we have added 1.7 new jobs in the last—1.7 million new jobs in the last year, as you know. I am looking at your August 10, Federal Open Markets committee release where you decided to raise the target for Federal funds by 25 basis points. In that, the committee said the economy appears poised to resume a stronger pace of expansion going forward. That was a few weeks ago. Do you still believe that is true?

Mr. GREENSPAN. Well, that statement was made at a time when the data that we had were for the month of June in a broad sense, which were quite weak, and we had early data for July. And as a consequence of that, the soft patch which we identified appeared to be converting into some pickup in economic activity. We had a big increase in automobile sales in July. Housing starts came up, as I indicated in my prepared remarks. If it weren't for the oil price spike, I would be very optimistic about where the economy is going.

Mr. PORTMAN. Do you still believe, though, that the economy is poised for growth?

Mr. GREENSPAN. Yes, as I said in my prepared remarks today.

Mr. PORTMAN. You talk about the BLS data you had, it is hopeful. Those of us who don't have access to that information I think should in part defer to the Fed, and by your decision a few weeks ago and by your statement today, I am encouraged by our economic growth.

Tax cuts, we have heard today that this is a burden on our economy, that we need to stop the tax relief. I know you feel differently about it, but I guess I would ask you specifically, were the tax cuts a good idea and was the timing appropriate?

Mr. GREENSPAN. Well, I have suggested that they were a good idea. In fact, I particularly thought that making a structural change in gradually reducing the double taxation on dividends was a very important structural advance, which I think in the long run has very important positive aspects for economic growth.

So I couldn't at the time suggest that the timing was going to be appropriate for short-term economic change. It turned out, I think more by chance than anything else, to be in fact very proper timing, but I don't think that economists can forecast that closely to use fiscal policy for short-term economic stimulus.

Mr. PORTMAN. We will hear proof of that this afternoon from CBO, where they are going to adjust the deficit down $60 billion for this year because revenues have actually increased this year despite the tax relief.

Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Baird.

Mr. BAIRD. Mr. Chairman, I thank the chairman for being here.

Mr. Chairman, we read today in the paper that the GAO has apparently indicated that Tom Scully, the former head of CMS, should not be receiving his salary, because at the time, he instructed a Medicare actuary to not give actuarial information to the United States Congress. Specifically, he apparently told the actuary that if he told the Congress that the Medicare drug bill would cost $530 billion instead of $400 billion, he would be fired.

I put that in the context of the President of the United States, who when he was running for office told the American people he would put Social Security in a lockbox, the trust funds; and, yet, when he talks about cutting the deficit in half, we would see, according to CBO numbers, that we would borrow not $150 billion from Social Security, as we do now, but $256 billion in 2010.

Secretary Wolfowitz was here right before the Iraq war and said to this committee that the notion that the war in Iraq would cost $100 billion and would require 100,000 troops was nonsense.

Now, I add those three up, and as we try to plan our financial future, if we are borrowing a quarter trillion dollars from Social Security when we said we would borrow nothing, if Medicare costs $130 billion, as we have been told, if the costs of the war are at least double what Secretary Wolfowitz said, it seems to me it makes it rather difficult for this Congress to pass appropriate policy.

Do you have any thoughts on that?

Mr. GREENSPAN. Not on what you have said, no.

Mr. BAIRD. Let me ask you a different question, then.

We have heard today that the economy went up, and we are glad that it did, and it is because of tax cuts. Have you given any examination to what would happen or might have happened to jobs, growth, et cetera, if instead of tax cuts to the top 1 percent of income, individuals in this country, we had invested in transportation infrastructure? There were legislation proposed to put, for example, $40 billion into infrastructure, roads, highways, bridges, et cetera. Any thoughts about the relative merit in terms of growth stimulation, job creation, et cetera, of infrastructure investment vis-a-vis tax cuts?

Mr. GREENSPAN. Congressman, those turn out to be very difficult judgments to make. You will find that you can get an array of economists up here, and you will find you have gotten four economists with seven answers. And the reason is that we have an exceptionally complex economy, and it is exceptionally difficult to trace the effects of a number of these various and different initiatives.

Mr. BAIRD. Given that, would it be fair to say that we cannot merely look at, yes, taxes were cut and the economy improved, and say that was the only thing that could have been done?

Mr. GREENSPAN. That is a fair statement.

Mr. BAIRD. That there are other things that could have been done that might have stimulated the economy more?

Mr. GREENSPAN. I can't deny that.

Mr. BAIRD. Thank you, sir. Thank you, chairman.

Chairman NUSSLE. Mr. Garrett.

Mr. GARRETT. I will yield.

Chairman NUSSLE. Then Mr. McCotter.

Mr. MCCOTTER. Thank you, Mr. Chairman.

I want to touch on a couple of points. When we talk about the PAYGO system, that would be a statutory remedy to Federal spending, would it not?

Mr. GREENSPAN. It would.

Mr. MCCOTTER. And the more stringent it would be for Congress to break through it, the happier, you think, the markets would be?

Mr. GREENSPAN. I would assume so.

Mr. MCCOTTER. So then would not a constitutional balanced budget amendment, which would be even more stringent and more difficult for Congress to break through, be better?

Mr. GREENSPAN. It depends on a broad question here of what one perceives the Constitution should cover, as distinct from statutes. I have been on both sides of this issue, and I think it has nothing to do with economics. It has more to do with how one views our constitutional system.

Mr. MCCOTTER. I would think it would be more stringent.

Mr. GREENSPAN. It certainly would be more stringent. The question is, do you want the Constitution to create economic policy in that context.

Mr. MCCOTTER. I think that the Constitution is required because you need something greater than the power of Congress to break through the statutes that can or cannot pass, to bind our hands, to protect us, which would make it more stringent.

Mr. GREENSPAN. If you believe that, then I think the answer is yes.

Mr. MCCOTTER. The question then for me is something that Representative Thornberry touched on, and I think it is kind of lost. It seems to me from every family board room to a corporate board room, family living room, when they make economic decisions, they try to make them on a rational basis. And what we have seen on September 11, and even sooner for some, was, we now have to factor in the inherently irrational act of terrorism in economic decisions. You said since September 11, the country has been resilient, but there is no way for anyone to understand when the American public as a whole, as an aggregate of these individual decisions, will feel comfortable enough factoring that decision into their long-term economic projections.

I ask that because my concern is, we are going to continue to see despite ourselves and despite fiscal policy in general, there are spits and sputters in the American economy as external events and the threat of terrorists continue to intercede. It might be one more reason for a company not to make a hire, for a family not to make an investment or a purchase, and we may see continued sputtering in this economy because of that.

Mr. GREENSPAN. I wouldn't disagree with what you said. To the extent you have these external events occurring in a voluntary economy, we are subject to that. And the only thing we can do is, one, try to find a way to eliminate the initiation of the terrorism, or two, structure an economy which is sufficiently flexible to absorb the shocks that those terrorist acts create.

Mr. MCCOTTER. Or both, which is what we are trying to do now.

Chairman NUSSLE. Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

To simplify this hearing, it seems you have come to us today and asked for a reinstatement of the budget rules that we lived under quite successfully for some 12 years after 1990. And those budget rules expired in 2002, and this Congress let them expire.

The key rule is PAYGO, which you offset by either spending increases or tax cuts. And I think essentially what you are hearing from this committee today is that even though you are in your forceful way asking us for those, this committee is letting you walk away empty-handed because the majority of this committee has been offered the vote on real PAYGO several times and the majority of this committee has refused to endorse it.

Even though those budget rules worked quite successfully, according to your view, for 12 years, we let them lapse in 2002, and all we need to do is reinstate them. And yet this committee is refusing to do so even though you say quite clearly in your testimony, it would help our economy to do that.

One of our gentleman friends on the other side is suggesting, well, we can't do PAYGO, let's do a constitutional amendment, which takes years to pass and implement, when we can do PAYGO this month if we wanted to.

So it is important to highlight in clear, simple terms, you are coming asking for PAYGO. The majority of this committee, the Republican majority of this committee, is making you walk away empty-handed; and I think that is tragic for our economy, because we know what to do, we know how to do it, and you are recommending it to us, and it has worked well for 12 years. And yet, we are not allowing that good policy to be reinstated.

That is a sad day for this country, when the solution is so close to our grasp, but yet the majority of this committee is refusing to grasp it.

You, in very gentle terms, told Mr. Brown that the supply side doesn't work. Assuming my colleagues on the other side want to continue to believe that tax cuts always pay for themselves, there is some offsetting revenue effect, but you stated to Mr. Brown that he was mistaken in his view, that they always pay for themselves.

We appreciate the economic reality you bring to this committee, but I wish a majority of this committee would give you what you came here asking for, which is PAYGO—PAYGO now to reinstate those rules that we lived with so successfully from 1990–2002. Would you care to comment?

Mr. GREENSPAN. I prefer not.

Mr. COOPER. Thank you.

Chairman NUSSLE. Mr. Franks.

Mr. FRANKS. Thank you, Mr. Chairman.

Chairman Greenspan, thank you for being here. The last time you were here, you made some similar statements related to some of the entitlements. We have been on an unsustainable trajectory. And those are things that a lot of us have been saying for a long time, suggesting that the best way to affect that is in the market reforms on the finance side.

Having said that, I think your erudite voice has been more compelling than just some conservative Congressman saying that. And I just hope that you continue to say that, because I think it may prevent this country from facing a mathematical paradox that could be addressed only by nothing short of a political cataclysm.

I would suggest to you that you said something else today that is equal in nature, and that is, you said—not to put words in your mouth—that this premium that skilled workers had over non-skilled workers was largely responsible for the differences in living standards in our society. And I believe that what you are saying is correct.

I believe that we economically segregate children at a very early age. I used to be the director of the governor's office for children in our State, and I am more convinced of that as we go along. And if you believe that, and I am convinced that you do, do you think that market forces and parental choice are reasonable elements to employ to try to correct that economical segregation? And if so, do you have other thoughts as well?

Mr. GREENSPAN. I think it is essential. First of all, let us remember that the real concern that we should have is that recent studies about the status of our schoolchildren relative to their counterparts in the rest of the world are not very favorable.

We start, for example, with studies showing that fourth graders in math and science do reasonably well relative to the rest of the world. By the 12th grade, they are all the way close to the bottom. Obviously, it can't be the children, the same children who existed in the fourth grade; we are doing something to them in the process, which other countries are not doing. And we ought to find out what it is that we are doing wrong and they are doing right.

Because unless we bring a significant proportion of those who are now ending up as lesser skilled in our society and, hence, creating a surplus of the lesser skilled relative to the demand in a highly technologically based economy, unless we reduce that level of surplus by moving them up to the skilled level and thereby raise the wage rates at the lesser-skilled level and lower them at the upper-skilled level, we are going to be confronted with what I think in a democratic society is a very difficult problem.

Mr. FRANKS. Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Emanuel.

Mr. EMANUEL. Thank you Mr. Chairman. I also have a question on skill sets, but two things I want to say beforehand.

One is, a number of colleagues have cited economic statistics. What they left out is, we have 44 million Americans without health insurance, which—33 million Americans work without health care; 4 million more Americans live in poverty today than did in 2001; wages and median income for families have been frozen or declined in the last 2 years; and health care costs and college costs, at the same time, have gone up by a third in the very year that the Congress is supposed to reauthorize the Higher Education Act.

All the economic statistics cited by the other side pointed to the board room, and none of the economic statistics they cited ever pointed to anybody's pay stub. If you went down to somebody's pay stub, income is flat and costs are up and that has been the impact of the economy.

In 1994, on January 31, you said the actions taken last year to reduce the Federal budget deficit have been instrumental in creating the basis for declining inflation expectations and easing pressures on long-term interest rates. On February 20, 1996, you said the deficit reduction in President Clinton's 1993 economic plan was an unquestioned factor in contributing to the improvement in economic activity that occurred thereafter. On January 4, 2000, you said, my colleagues and I have been very appreciative of your—President Clinton's—support of the Fed over the years. Your commitment to fiscal discipline which, as you know and indeed have indicated, has been instrumental in achieving, one, of the past few weeks, as you point out, will be the longest economic expansion in the Nation's history.

If fiscal discipline was good then, and you cited it over 9 years as good, I would assume it is good now. And if fiscal discipline was good for economic growth and economic activity, and if the chemistry in which we used to create that condition was good then, then the opposite of what we have today, which are higher deficits, in fact are not good for long-term interest rates and long-term economic growth.

I don't want to give you another question, but if the basis of your points over 6 years about deficit reduction being good for the economy was good then, it would be good now.

You and I at another point discussed the skill gap as really underscoring the income gap that we have here, and it is really the gap that exists in our society in that we can't sustain as a society that kind of gap. Have you looked at maybe making the first 2 years of college universal and free, like we made 4 years universal and free at the beginning of the Industrial Revolution; that we would do something different about higher education for the new economy and the new stage we are in, in the same way we did for high school education at the early stages of the Industrial Revolution? Has the Fed ever looked at that from a policy analysis?

Mr. GREENSPAN. We haven't, and the reason is, you are getting into the details of our educational system, which I—and I presume most of my colleagues—don't have the expertise to make judgments about.

But clearly community colleges, one can judge, have been growing very rapidly. In fact, they are the most rapidly growing aspect of our educational system. And that is saying that the markets are working because they are in the forefront of what I would call lifetime education. People are continuously going back to community colleges. I think the average age of full-time students is in the high 20s, and what that tells me is that there is a huge demand out there for these new types of educational skills.

And it is that type of focus that is needed in a system such as ours in which the job requirements are continuously churning and in which the turnover of jobs is extraordinary. Remember, we hire a million people a week in our economy and separate roughly the same number. And this particular process means that unless you move the people on the wrong side of that million, the ones who are losing their jobs, and find ways to move up their skill levels, we are not going to address this problem in an appropriate way, in my judgment.

Mr. EMANUEL. Thank you, Mr. Chairman.

Chairman NUSSLE. I have three members and if we do this in 3 minutes, we will get you out of here. Mr. Lewis.

Mr. LEWIS. Thank you, Mr. Chairman. I will be very brief.

Thank you, Mr. Chairman, for being here today. You have been very patient. I want to know, do you favor this proposal that we should be allowed to privatize part of Social Security? I know there were others in the administration—where do you come down?

Mr. GREENSPAN. I have been in favor of finding some way to get away from a defined benefit type of program, which is essentially what Social Security is. But it is a very complex issue, Congressman, and I don't know if I can do it justice in this very short period of time. But it is a major issue which the Congress needs to address.

Mr. LEWIS. Do you think or have any feeling where we engage in these unbelievable tax cuts that we are taking from the wellbeing of Social Security and maybe Medicare?

Mr. GREENSPAN. I didn't get the question.

Mr. LEWIS. I don't want to use the word "stealing," but do you think we are taking from the strength, the welfare of Social Security and Medicare?

Mr. GREENSPAN. The purpose of the tax cuts is essentially to increase the growth rate of the economy and the overall depth of the economy, which over the longer run would mean that if it is working properly that it would be easier to finance Social Security benefits. So I don't think that you can call it "stealing."

I think what you can say is, it is a different point of view as to the way our society and economy will function. And consequently, I think everybody is in favor of higher benefits for retirees and higher medical expenditures as is feasible. And the only question, I think, that is involved here is what is the most feasible way to address that question.

And there are disputes and there will be dispute amongst economists on these issues as there will be in the Congress. And there is no shortcut to concluding other than debating the issues and each Member of the Congress coming to a conclusion.

Mr. LEWIS. In your statement, you imply that we don't have much time and time is not on our side in dealing with the question of health care and also retirement.

Mr. GREENSPAN. We do have several years. It is not something that needs to be addressed tomorrow or the day after. But unless we start the process fairly soon, the inexorable turn of the clock is going to find us up against a very significant problem without having prepared our budgetary system for it.

Chairman NUSSLE. Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman.

And, Mr. Greenspan, I appreciate your patience. I had a couple of charts I wanted to—on this one. This is a time period going back to Herbert Hoover, the number of—the job growth since Herbert Hoover, a time period that includes Pearl Harbor, World War II, the Korean War, Vietnam, the cold war, hostages in Iran, Persian Gulf War—does that reflect the number of jobs created by each administration showing that this administration is the worst since Herbert Hoover?

Mr. GREENSPAN. Yes. I would also think that if you put up a productivity chart of a similar nature, you would find that this has been the period amongst all of those different, varying Presidential regimes that has the highest rate of growth in productivity; and yet the trouble, unfortunately, is that one is causing the other. And that is what I mentioned earlier with respect to the productivity issue and the shallowness of the recession, which has been the major contributor to job loss.

Mr. SCOTT. Without the explanation, this does show the job loss?

Mr. GREENSPAN. That is an accurate chart.

Mr. SCOTT. You are familiar with this chart that shows the deficit. The green in the middle is the Clinton administration when we had PAYGO. Does this chart represent a $650 billion deterioration in the budget? Is that chart accurate, to the best of your knowledge?

Mr. GREENSPAN. As far as I can judge.

Mr. SCOTT. Next is the present value of the Social Security and Medicare deficits and the present value of this administration's tax cuts. It shows that the administration's tax cuts, the present value of those is significantly more than the Social Security shortfall and the Medicare shortfall combined. Does that reflect the choice we had? We can cut taxes and take care of Medicare and Social Security?

Mr. GREENSPAN. I can't confirm those numbers. I don't know if they are accurate or not, but just reiterate my of earlier statements, what has been missing in this budgetary process for a number of years since September of 2002 is the necessity to make choices.

Mr. SCOTT. And the final chart shows that we have in the last few years increased new debt by $638 billion, the foreign portion purchased by foreigners, approximately $729 billion. Can you say what the foreign policy and national security implications are of a substantial portion of our debt being owned by foreigners?

Mr. GREENSPAN. It is an interesting question, which we at the Federal Reserve have given considerable thought to, because clearly we, at the end of the day, are responsible for the American financial system. We are the lender of last resort in that sense.

It turns out that a very large part of the foreign purchases—is that the Federal debt numbers you have up there?

Mr. SCOTT. Yes.

Mr. GREENSPAN. Federal debt. It is very substantially—I just can't see some of the numbers up there—it is very substantially very short-term instruments, and these instruments compete in a very huge market in the private sector. So that in response to the implication that you are trying to raise, namely that were foreigners, either for purposes malicious or otherwise, withdrawing from purchasing substantial amounts, would that have a major impact on our interest rates and on our economy and the financial structure generally, our conclusion is "no." And the reason for the "no" is that such a substantial part of the debt competes with vast amounts of private instruments.

Does it have some effect? Yes, it does have some effect, but it is not the type of effect which raises significant problems with respect to our foreign posture.

Mr. SCOTT. Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Davis.

Mr. DAVIS. Thank you for letting all the members—and, Chairman Greenspan, thank you for your indulgence. You talked a fair amount in this hearing about the impact on the psychology of the market if some of the tax cuts were suspended and how that could impact investor confidence and a number of other things. Let me focus on a slightly different problem.

Let us say that the institutional moment arrived when Congress decided to make draconian cuts in entitlement programs—Social Security, Medicare, for example. If that institutional moment arrived, a concern of mine is that that would also have a profound impact on the psychology of the economy in this country. Significant numbers of seniors would feel that their investments, or what they perceive as their investments, were imperiled, or that programs that could provide a lifeline to them were somehow imperiled.

Can you comment on that for a moment? And then I have one last question I want to ask you.

Mr. GREENSPAN. It is hard to know what the psychological effect is, but I agree there could be some response, which is the reason why I think you have to address these problems in a gradualist way and not find yourself up against a crisis which requires an immediate and draconian fiscal policy.

We are talking about 2015 as sort of a critical year when these things begin to mushroom. I should think that if we can anticipate out that far, which I believe we can, we can certainly reorder our priorities in a manner with people who, instead of finding at the last minute that all of a sudden they had programmed into their retirement incomes and expenditures funds which they will not get—that that, I think, is extraordinarily unfair, and we have to act well in advance.

Mr. DAVIS. I agree with you. And let me slip in another observation as my time and your time run out.

You made the point accurately before in other hearings that there is a fundamental problem, or the risk of a fundamental problem, when it comes to inequity in our society; and you have made the accurate observation that the perception of inequity can sometimes be devastating in its own right.

I would end with this observation: If Congress at some point makes draconian cuts to entitlement programs, when you combine that with the tax burden in this country rising on middle-income people as it proportionately falls on upper-income people, and when you combine one other factor, the impact on income assistance programs, if we cut those, my concern—if I could close out—my concern is that we could put ourselves in very much the bind that you have described to this committee and others, that we could make choices that don't appear to be equitable to the American people, and we could make choices that are inequitable on their face.

And if you could react to that, I would appreciate it.

Mr. GREENSPAN. I think a democratic society functions only if people believe that it is a fair and equitable society. Those which have had problems occur to a large extent because there is a deep-seated belief that there is an underlying lack of fairness.

I think the success of our society over the generations has been, there is a sense of opportunity and freedom, which has been crucial to the development of a sense of values which are held virtually by every American. Indeed, the Bill of Rights, for example, is essentially, I would say agreed to possibly by not 100 percent, but close to 100 percent of our population.

Mr. DAVIS. You said it better than Senator Kerry says it some days.

Chairman NUSSLE. It is tempting.

Mr. Chairman, we congratulate you for re-upping for another term. We look forward to working with you and for your generosity of time to come before this committee.

Unless you have anything else to say before this committee—if you do, I would be happy to hear it. Otherwise, we would stand adjourned.

Mr. GREENSPAN. Thank you very much.

[Whereupon, at 12:55 p.m., the committee was adjourned.]

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